inboundcapital

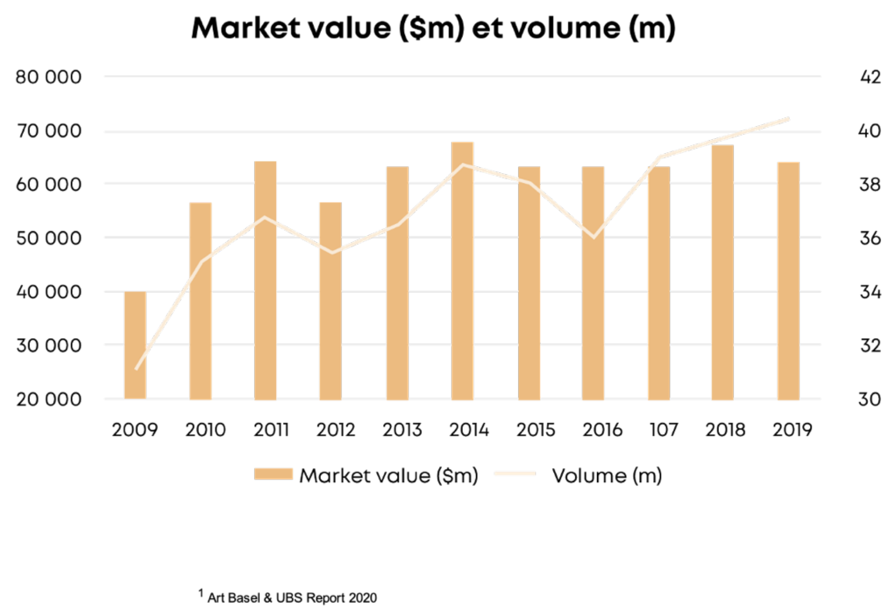
White Paper

ART'S INEVITABLE DIGITAL LEAP FORWARD (And why digital investors should care)

For all its sins, the pandemic has been a blessing in disguise for the long-awaited digitalisation of the art sector. To date, few large sectors have managed to repel the digital invasion and keep doing business the old-fashioned way: art was one of them. The general lockdown has triggered a "digital conversion by necessity" whose positive effects are only just getting felt in art and beyond in connected areas like wealth management. In a sector where trust is pivotal, technology can bring a long overdue resolution to information asymmetry, opacity of transactions and other issues like insufficient traceability. Investors should pay attention to start-ups like Arteïa, Artmyn or Singulart that act as positive agents of change in this digital evolution.

THE ART MARKET'S PARADOX

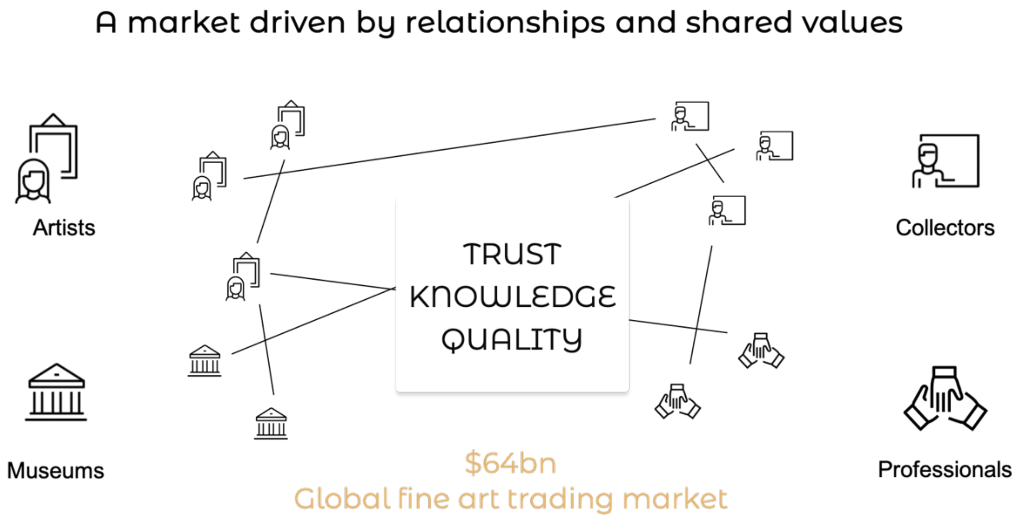
Ask anyone and most will tell you that art matters in their life - sometimes passionately. Yet very few people know about the art sector, as if it were shrouded in secretive and intimidating rules. Art is not a niche sector either: the fine art trading market was estimated at $64bn last year and the value of artworks and collectibles owned by High Net Worth (HNW) investors world-wide at $1.7 trillion, generating more than 40m individual transactions annually – of which less than 10% online ($6bn).



Source: Art Basel & UBS Report 2020

THE GROWING ILLS OF A CLOAK-AND-DAGGER SECTOR

Because it touches so profoundly on personal wealth and status, inheritance and tastes, i.e. privacy and emotions, the art sector has functioned around its own unwritten code and set of rules based on trusted (often centennial) relationships, shared values and expertise. This has led to a business environment where confidentiality is key and a market which remains largely unregulated, reminiscent of business practices of the Medicis. Private transactions still account for more than half of all art transactions.



Source: Inbound Capital

The consequence has been a polarisation between:

- A perceived elite "in the know" at the top of the sector pyramid: HNW buyers and sellers, World renowned artists, international galleries and leading auction houses, and
- An atomised pyramid bottom of more than 200,000 small players, who nonetheless make up the bulk of the sector's trade for single transactions, themselves serviced by a plethora of sub-scale service providers (for storage, shipping, framing, software etc) lacking integration efficiencies and scale economies. Absent regulatory oversight has until recently meant there was no pressure to interconnect systems and standardise processes.

Price transparency has long been a notorious issue for a market which keeps leaning towards discretion bordering secrecy, as shown by the resilience of dealer sales (58% of the art market last year vs. 42% for auction sales).

The information asymmetry and illiquidity generated by age-old habits have conspired to generate considerable inefficiencies – not least expensive intermediary fees (up to 45%) – and growing frustration for a large fraction of artists and emerging buyers and sellers.

Last but not least, the sector *modus operandi* has created an ideal environment for fraudulent activities including money laundering via the buying, selling and collateralisation of art. This perennial risk in the sector has grown bigger through globalisation, marked by the emergence of so-called freeports (tax-haven storage units) or the growing sophistication of certain schemes using artwork bought with illegal funds used as collateral against "clean" loans.

BOOST TO SECULAR PRESSURE TO CHANGE

Not unlike the financial industry, the art sector has been facing two secular trends – increasing regulation and the growing importance of technology – accelerated by recent catalysts:

- **Catalyst #1: the EU's 5th Anti-Money Laundering Directive (January 2020)**

Among other new requirements, the Directive made compulsory for the seller of any artwork worth more than €10,000 to register the purchaser's identity, address and other personal information (passport detail etc). A culmination of efforts to bring greater transparency into art transactions – from price information to KYC, the Directive was the first concerted effort by the EU, the UK (where it became law in January 2020) and the US to fight money laundering specifically in the art sector specifically.

It has helped cast a light on key issues begging for attention: authentication (i.e. an original work by its acknowledged creator), provenance (i.e. a documented chain of respectable ownerships), traceability and ownership title – areas where technology, from blockchain to AI, is increasingly playing a critical role as well.

- **Catalyst #2: the impact of lockdown on digital adoption**

While the lockdown has negatively impacted art events in their physical format (e.g. VIP attendance at TEFAF Maastricht was down 20% vs. last year visitor numbers and the Armory Show in NYC footfall was down 28%), it has been an accelerator for the market's digital transition.

This even applies to some of the sector's more brick-and-mortar - or colour-and-canvas – areas like auction houses and galleries, which have all witnessed a surge in interest and usage of digital technology, from online auctions to virtual viewings. Some auction houses have registered twice the attendance with Zoom or Teams-based sales vs. previous real-life sales. Confirming that a click is easier and faster than a phone call, at a recent auction, Sotheby's recorded more than 50% of first-time bidders (up from a 33% three years ago) coming through the online route rather than live sales – most made a transaction.

Recently Paris-based Artprice.com (PRT FP) endorsed Mark Thompson, CEO of the New York Times saying: "even before Covid-19 there was profound disruption impacting the industry. All that we thought would happen in five to ten years is happening in five to ten months." This phenomenon is compounded by a generational change of art buyers and sellers, marked by the growing importance of the more tech-savvy and "open-source" generations Y and Z.

DIGITAL RESISTANCE IS FUTILE: - AND UNWARRANTED

Georges Braque said: *Art is meant to disturb, science reassures*, but the science he referred to did not include digital. Like Asterix' little village fighting tooth and nail to resist the Roman invasion, the art sector has fought "pencils and brushes" against digitalisation, which it found to be irrelevant to its approach based on *intuitu* personae relationships, intrusive and slightly frightening. Indeed most museums were not convinced by the utility of online tools up until a few years ago. And because galleries function with smaller budgets and more often than not on very thin margins, they have been slow to embrace digital and make the necessary investment in IT development and skills beyond a social media account and a static website.

- **Cyber crimes**

A growing online activity has obviously meant greater cyber-security risks for a sector that by nature has been appealing to fraudsters given the large sums of money involved, the opacity bred by confidentiality and the relatively lack of digital education of many inexperienced art buyers and sellers.

While the general awareness about such risks and safeguards has increased – especially since the much-advertised Rijksmuseum Twenthe scam in 2018 (**) - the lockdown has again increased cyber-security hazards again, from phishing for personal information to fake opportunities.

(**) The Rijksmuseum Twenthe in Amsterdam was tricked into sending £2.5m to what it thought was the right bank account in Hong Kong for the purchase of a John Constable's painting from London's Dickinson Gallery.

- **Adapting contract law to online**

With online migration gaining momentum in an increasingly global sector, art galleries have had to ensure that they had sales contracts adapted to the new way of conducting business – in regard especially to the main jurisdiction of the transaction when done across multiple locations, e.g. a London-based gallery selling artwork to a buyer in NYC through Art Basel's Online Viewing Rooms (OVRs), which is governed by Swiss law. Online platform will typically use their home country as their stated legal jurisdiction and stipulate that they have no legal responsibilities for transactions.

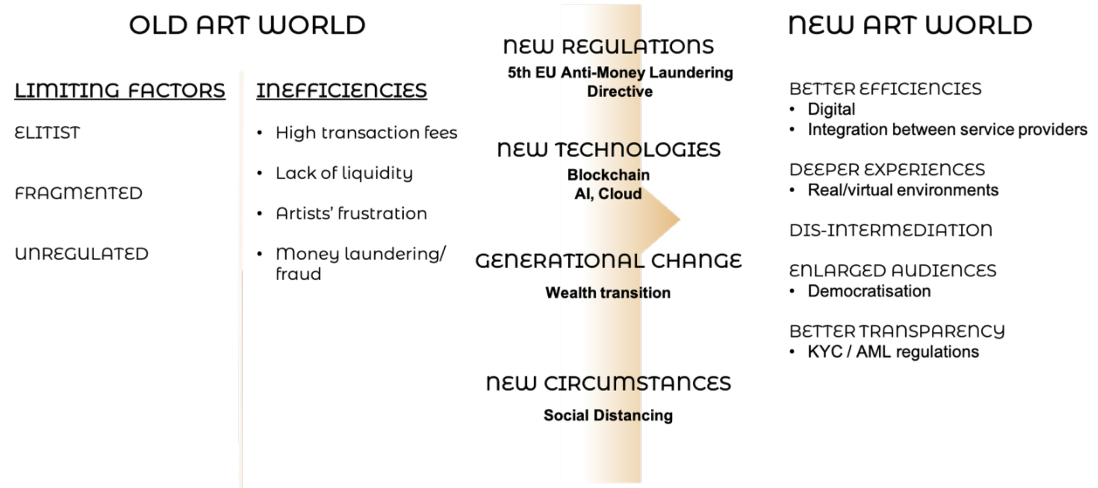
- **All outweighed by the hook on the neck, for much bigger benefits**

With these potential issues in mind, the benefits of the digital migration for the art market are arguably much more substantial, ranging from better efficiencies to enhanced experiences for an enlarged buyer' and seller's audience:

- Stronger efficiencies from dis-intermediating expensive middlemen, visibility/traceability (KYC, regulation), better integration between service providers but most importantly price transparency. For example, all works shown at the Art Basel Hong Kong OVRs in March were for the first time displayed with their price or a at least a price range.
- Market growth thanks to better price transparency increasing buying propensity – online resource Artsy mentioned last year that works uploaded to its site with a publicly available price were up to six times more likely to sell – increased by easier ways to buy and sell online as well as the new ways to enjoy art and deeper experiences thanks to augmented reality and virtual environments . Frieze was the first major art fair to offer augmented reality with a dedicated app allowing digital visitors to superimpose on the walls or floors of their homes the works of the galleries participating online. London-based Lisson Gallery launched a platform through Augment, an app allowing clients to try works at home virtually before they buy – solving the expensive and complicated problem of shipping works for approval. The competition amongst vendors for new digital solutions goes on.

Private banking and wealth management firms should be positively impacted by the improved traceability of artwork and visibility on transactions. With more than 35% of their HNW clients active in the arts and collectibles markets, they have been increasingly asked for advisory and management services concerning art collections: from basic services (e.g. storage, transport) to more sophisticated ones such as art appraisal, advice on whether to transact or not, exhibition loans, collection management and structured finance. Collateralised loans have been a major way to unlock money against the value of illiquid art assets to finance their clients' lifestyle and projects. The value of such loans has reportedly grown 10-15% every year over the past 10 years.

As a result, most private banking names have assembled highly specialised art advisory teams (former curators, gallerists, other art specialists) who work hand in hand with financial planning (inheritance/succession) and structured products teams.



Source: *Inbound Capital*

WHICH DIGITAL PLAYERS FOR THE NEW ART WORLD?

In 2020, we expect the global fine art market to shrink by 32% to c.$44bn. Online sales should partially make up the shortfall in traditional (i.e. physical) format – down 45% to $32bn due to the negative impact of social distancing measures and travel restrictions even after the lockdown was lifted,. We expect online sales to double to c.$12bn, trebling its share of the total market since last year (from 9.2% to 27%).

Start-ups and pure online players focusing on the art sector have a key role to play to accelerate this transition and make the market more resilient, transparent and open to new entrants – buyers, sellers and innovative intermediaries and service providers alike. Positioned as positive agents of change, watch these start-ups that help solve the three main issues of the art market: opaque provenance, lack of transparency and poor liquidity.

Meanwhile, this is arguably a time of reckoning for several established online players, who have never really managed to achieve much traction in these regards – at the expense of their shareholders whether they are listed or not.

In fact, because they enjoy a closer relationship with the "buyers/sellers of tomorrow" and a technological edge with their teams of programmers, start-ups are in a better position to ride the digital acceleration triggered by Covid-19. Yet here again few take a holistic approach to offer a comprehensive set of solutions to both the current and the emerging demands of the art market. Most seem to contend themselves with the translation of a simple model from offline to online like art galleries – such as Paris-based Singulart which recently raised €10m, testimony of the investors' interest into the space.

Others have tried to aim straight for the Holy Grail – the digital marketplace, failing to realise that it is indeed the end game and not just a buzz word. They have done it at vast expense – their shareholders' mainly – forgetting to put essential building blocks first and financial discipline along the way.

Whether replicating online the old model or pretending to overtake the market place, these are obvious traps [Arteïa](#) with its long-term and integrative approach is not falling into – as exemplified by its partnership with leading art publisher Cahiers d'Art to offer online Catalogues Raisonnés, (securing with blockchain technology the online catalogue of certified artworks of an artist) and the Art Identification Standard (AIS) initiative aimed to provide a new nomenclature of relations between market players, which [Arteïa](#) is spearheading. Irrespective of the technological prowess involved, a successful marketplace is a collaborative journey keeping all artists and collectors nurtured and at the heart of the ecosystem - for emotions to remain its beating engine.

	COLLECTION OPTIMISATION	DUE DILIGENCE					LOGISTICS	EXCHANGE			
	ART CONTENT MANAGEMENT	INSURANCE	CONDITION REPORT	PROVENANCE TECHNOLOGY	CERTIFICATE OF AUTHENTICITY	SCANNING TECHNOLOGY	SHIPPING/ LABELLING & PACKAGING	EXHIBITION LENDING	PEER TO PEER	AUCTION	MARKET PLACE
ARTEÏA	✓	✓	✓	✓	✓✓	✓	✓	✓	✓	✓	✓
Arteïa's partners & potential partners											
4 ART					✓	✓					
Articheck			✓								
Artmyn					✓	✓					
Convelio							✓				
Vastari								✓			
Artory				✓							
Other players											
1stdibs										✓	✓
ArtBinder	✓										
Artlogic	✓										
Artsy										✓	✓
Artland											✓
Codex protocol				✓							
Collectrium	✓										
Everledger				✓							
Maecenas											✓
Verisart					✓						
Tagsmart					✓						

✓ Arteïa standalone ✓ Arteïa in partnership with other players

Source: Inbound Capital

Inbound Capital acts as advisor to Arteïa for its current funding round

Claire Barbaret

cbarbaret@inbound.capital